Nos. 13-1421, 14-163

Supreme Court, U.S.
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Supreme Court of the United States

BANK OF AMERICA, N.A.,

Petitioner,

—v.—

DAVID B. CAULKETT,

Respondent.

BANK OF AMERICA, N.A.,

Petitioner,

—v.—

EDELMIRO TOLEDO-CARDONA,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

BRIEF FOR *AMICI CURIAE* PROFESSORS JAGDEEP S. BHANDARI, SUSAN BLOCK-LIEB, LINDA COCO, JESSICA DAWN GABEL, KENNETH N. KLEE, GEORGE W. KUNEY, LOIS R. LUPICA, LAWRENCE PONOROFF, C. SCOTT PRYOR, NANCY B. RAPOPORT, MARIE T. REILLY, KEITH SHARFMAN, AND MICHAEL SOUSA IN SUPPORT OF RESPONDENTS

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INTEREST OF *AMICI*[1]

The *amici*[2] are a group of law professors who have devoted their careers to the study and teaching of bankruptcy law. Their interest is to encourage the Court to apply the Bankruptcy Code (the "Code")[3] in light of its overall structure and to read its provisions consistently, thereby providing predictability for future cases. The *amici* are keenly interested in this appeal because the outcome of the issue before the Court will have an impact on an enormous number of business and

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[1] Pursuant to Rule 37 of the Rules of this Court, the *amici* file this brief with the written consent of both parties, which are on file with the Clerk. No person or entity including the *amici* or their counsel made a monetary contribution for the preparation or submission of this brief.

[2] The *amici* are the following law professors who teach at the law schools indicated next to their names: *Jagdeep S. Bhandari*, Florida Coastal College of Law; *Susan Block-Lieb*, Fordham University School of Law; *Linda Coco*, Barry University School of Law; *Jessica Dawn Gabel*, Georgia State University College of Law; *Kenneth N. Klee*, UCLA School of Law; *George W. Kuney*, University of Tennessee College of Law; *Lois R. Lupica*, University of Maine School of Law; *Lawrence Ponoroff*, University of Arizona James E. Rogers College of Law; *C. Scott Pryor*, Regent University School of Law; *Nancy B. Rapoport*, University of Nevada William S. Boyd School of Law; *Marie T. Reilly*, Penn State University Dickenson School of Law; *Keith Sharfman*, St. John's University School of Law; and *Michael Sousa*, University of Denver Sturm College of Law. The positions taken in this brief are theirs alone and may not be attributed to their law schools or any law firms with which they are affiliated or clients whom they represent in unrelated matters.

[3] All references in this brief to numbered sections are to the Bankruptcy Code, 11 U.S.C.

individual debtors seeking a fresh start under chapter 7 of the Code. Chapter 7 debtors often hold property, including their homes, subject to a first mortgage and sometimes also subject to a valueless junior mortgage. The *amici* believe that the correct view of section 506(d) of the Code is that it provides for stripping off a wholly valueless junior mortgage in a chapter 7 case, thereby furthering the debtor's opportunity for a fresh start.

SUMMARY OF ARGUMENT

When the collateral for a claim secured by a second mortgage lacks sufficient value to provide full payment of the first mortgage claim, it should not be treated as an "allowed secured claim" under section 506(d) of the Code. This is because such a claim constitutes an unsecured claim, not a secured claim under the clear definitions of "secured claim" and "unsecured claim" in section 506(a) of the Code. This reading of the Code is supported by a pre-Code practice under which valueless junior mortgages were stripped off.

Decades before the enactment of the Code, this Court's jurisprudence regarding the treatment of junior secured creditors in bankruptcy cases established that their rights were limited to the value of the collateral securing their claims. This was the established practice in reorganization cases, under which valueless junior mortgages were terminated, in recognition of the fact that they had no value that needed protection.

During the pre-Code era, the cases before this Court in which liens passed through bankruptcy

involved first mortgage liens, whereas in several other cases addressed by this Court it held that worthless junior mortgage liens should be treated as unsecured claims. As held in *Wright v. Union Central Life Ins. Co.*, 311 U.S. 273, 278 (1940) (herein "*Union Central*"), a junior mortgage is entitled to protection only to the extent of the value of the collateral. However, *Dewsnup v. Timm*, 502 U.S. 410 (1992) (herein "*Dewsnup*"), in addressing the treatment of a first mortgage, relied on the pre-Code case law under which first mortgages backed by some collateral value could survive a bankruptcy. Notably, *Dewsnup* lacks any discussion of this Court's carefully developed pre-Code jurisprudence authorizing the stripoff of valueless second mortgages. *See In re 620 Church Street Bldg. Corp.*, 299 U.S. 24 (1936) (herein "*Church Street*"); *Ecker v. Western Pac. R. R. Corp.*, 318 U.S. 448 (1943) (herein "*Ecker*").

A half-century later, this Court, in *Dewsnup*, addressed the treatment under the Code of a partially secured first mortgage. In holding that a first mortgage could not be stripped down under section 506(d), the Court did not address whether a valueless second mortgage could be stripped off and did not cite this Court's groundbreaking pre-Code decisions under which valueless second mortgages were stripped off. In *Dewsnup*, this Court held that when a claim's collateral covered 32.5% of the first mortgage debt, the mortgage could not be stripped down to its value under section 506(d) in a chapter 7 case. The Court, however, candidly acknowledged that it was inclined to rule otherwise and to read "allowed secured claim" in section 506(d) in accordance with section 506(a). The Court also carefully

limited its holding to the "strip down" issue posed where a mortgage is backed by some collateral value, stating that its resolution of the issue posed by "other facts" would "await their resolution on another day." *Id.* at 416–17. This Court is presented with an opportunity to consider in this case "other facts" that give rise to whether its theory in *Dewsnup* should be applied in resolving the treatment of a valueless second mortgage under section 506(d). The *amici* submit that the Court's analysis in *Dewsnup* for rejecting strip downs of partially secured first mortgages does not apply to require the survival after bankruptcy of a valueless second mortgage.

In construing the text of section 506 as ambiguous, the Court in *Dewsnup* relied on what it said was "the pre-Code rule that liens pass through bankruptcy unaffected." *Dewnsup*, 502 U.S. at 417. However, this Court's pre-Code jurisprudence on the treatment of mortgages in bankruptcy cases makes clear that liens did not always pass through bankruptcy unaffected, and indeed that valueless mortgages were stripped off under a bankruptcy statute. Although the Court's jurisprudence allowing the stripoff of valueless second mortgages developed in reorganization cases, the Court's underlying theory was based on the valuelessness of the mortgaged property, not because the case sought reorganization. The Court's stripoff theory is no less applicable in a chapter 7 case than in cases under other chapters of the Code, although section 1123(a)(5)(E) expressly authorizes the modification of liens under a chapter 11 reorganization plan.

The Court in *Dewsnup* also relied on *Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555

(1935) (herein "*Radford*"), without citation to the important opinions of this Court that followed closely after *Radford* during the 1930s and 1940s. As the *amici* show, *Union Central*, *Church Street*, and *Ecker* negated *Radford*. These later decisions rejected *Radford*'s focus on the property rights of a first mortgage holder, and its original contract bargain, and instead were informed by a debtor's entitlement to a fresh start implemented by the discharge provision of the bankruptcy law. The Court in *Dewsnup* also relied on *Long v. Bullard*, 117 U.S. 617 (1886) (herein "*Long*"), which held that a debtor's discharge in bankruptcy only discharged his personal liability for the mortgage debt, but did not discharge the mortgage itself. *Long*, however, did not establish a principle or rule of law that a mortgage could not be voided for a reason *other than* the discharge. Indeed, *Long* never stated that liens pass through bankruptcy unaffected. Although that case did not establish that there was a practice for liens to pass through bankruptcy unaffected, later cases misread it for that principle, without examining the pre-Code decisions of this Court under which junior mortgages were voided.

The *amici* urge this Court to apply its early decisions allowing liens to be stripped off as the basis for reading section 506(d) as authorizing the voiding of a valueless second mortgage. Furthermore, under the Code as enacted in 1978, liens clearly do not pass through bankruptcy unaffected. Contrary to petitioner's contention, no mandate can be found in the Code for liens to pass through bankruptcy unaffected, which is underscored by the numerous provisions of the Code under which liens are modified or even

removed. Indeed, such other provisions provide for affecting mortgages in various ways, without regard to whether the collateral has value to cover the debt. Section 506 was written to deal with the very situation in which liens are undersecured or wholly unsecured and are not covered by these other lien-affecting provisions. Section 506(a), as a part of the overall structure of the Code in regard to the treatment of liens, establishes for purposes of other Code provisions, including section 506(d), that a claim secured by a lien on property is a "secured claim" only to the extent of the value of the property.

Moreover, petitioner's contention that 506(d) exists solely to void secured claims that are disallowed under section 502, is facially erroneous. Reading 506(d) in such a manner would render it supefluous, because by operation of law a lien is *already* void if the underlying claim is unenforceable. This Court is loath to read a statute in such a manner.

The Code's "limited to value" theory is strongly supported by the fresh start objective of its discharge provision. A debtor's fresh start should not be impaired by treating a valueless mortgage as if it has value. A discha ge is designed to free honest debtors from their dischargeable unsecured debt so as to give them an opportunity for a fresh start. Many holders of first mortgages enter into post-bankruptcy agreements revising their claims providing, among other arrangements, for deferred payments or reducing the amount of the claim. There is good reason to encourage the making of such agreements. They enhance the debtor's opportunity for a fresh start by enabling

the debtor to retain his or her property. They also benefit first mortgagees because such agreements offer them a chance to effect a larger recovery than otherwise, and to avoid the cost, delay, and uncertainty of a mortgage foreclosure proceeding. However, such a post-bankruptcy agreement cannot be effectuated without the consent of the second mortgage holder. This is good reason to allow the stripoff of a valueless second mortgage. The denial of a right to strip off a wholly underwater second mortgage would only serve to allow its holder, until it could extract some payment on its valueless mortgage, to stand in the way of a new agreement between the debtor and the first mortgagee revising the mortgage debt.

Petitioner's *amici* do not offer a cogent economic basis for precluding stripoffs of valueless junior mortgages. The *amicus* brief of its *amici*, Loan Syndications and Trading Association, *et al.* (herein together, "LSTA") opposes allowing stripoffs. It relies primarily on a short article in a periodical, which states that there is a demand by private equity investment firms for junior mortgages because "[i]n today's yield-starved landscape, second-lien loans are an oasis of relatively high margins." LSTA's *amicus* brief at 6 n. 4 (citing Forbes.com article, March 14, 2014). The interest of the LSTA *amici* in the investment opportunities and large profits for their constituencies is understandable, but does not demonstrate that allowing stripoffs in chapter 7 cases will produce the dire consequences they suggest will result. Indeed, the United States, which filed an *amicus* brief in *Dewsnup* because of its keen interest in *first* mortgages, chose *not* to file an *amicus* brief in this case. The silence of the

United States in this case suggests that the concern of petitioner's *amici* with allowing the stripoff of valueless junior mortgages is unwarranted. The concerns of LSTA and their constituencies should be directed to the Congress, not this Court.

ARGUMENT

POINT I

UNDER THIS COURT'S PRE-CODE JURISPRUDENCE, A MORTGAGE THAT HAS NO UNDERLYING COLLATERAL VALUE MAY BE STRIPPED OFF AND THEREBY ELIMINATED

A. *DEWSNUP* DOES NOT PRECLUDE THE STRIP-OFF OF A VALUELESS JUNIOR MORTGAGE

There was a pre-Code practice under which wholly underwater junior mortgages were stripped off in bankruptcy. This practice implemented this Court's pre-Code jurisprudence that developed under reorganization statutes enacted by Congress in the 1930s. As analyzed by the Court, a wholly underwater junior mortgage had no value, and thus needed no protection. The Court's theory was based on the valuelessness of such a mortgage, not because the question as to the treatment of a secured claim arose under a reorganization statute. The Court's jurisprudence applies equally in a bankruptcy case for liquidation. A valueless junior mortgage does not gain value because the question of its treatment arises in a liquidation case, or lacks value only when addressed in a reorganization case. A valueless junior mortgage should thus be subject to a stripoff in any case under the bankruptcy law.

There is a difference between a valueless second mortgage and a first mortgage backed by at least some value. It is most unusual for the foreclosure of a mortgage to yield proceeds in an amount sufficient to cover even the entire amount of the first mortgage on the property. Second mortgages are generally just out of the money. This Court's decision in *Dewsnup* should be understood in that light. In *Dewsnup*, the mortgagee's claim of approximately $120,000 was backed by mortgaged property valued by the court at $39,000, or only 32.5% of the debt. *See Dewsnup*, 502 U.S. at 413. *Dewsnup* addressed a partially secured claim. The treatment of a wholly unsecured claim was not before the Court, and its opinion neither reached that issue nor addressed it. This issue is among those left by the Court in *Dewsnup* for resolution on another day. *See Id.* at 417.

Although *Dewsnup* poses a very different issue than is presented by this case, petitioner and its *amici*, LSTA, rely on *Dewsnup*'s approach to the treatment of first mortgages backed by collateral as dispositive of this case. They mistakenly urge that *Dewsnup* applies because of a claimed pre-Code practice for liens to pass through bankruptcy unaffected. That assertion is wrong on its face because of the pre-Code practice under which wholly underwater second mortgages were extinguished and thus did not pass through bankruptcy at all. *Dewsnup*'s recognition of the pre-Code practice should be limited to the treatment of first mortgages, which may have often survived bankruptcy. Moreover, petitioner and its *amici* also mistakenly assert this Court's 1935 decision in *Radford* as controlling precedent. *Radford*, like *Dewsnup*, did not address the

treatment of a valueless mortgage. More importantly, *Radford*'s statement that a mortgagee could "insist upon full payment before giving up his security," 295 U.S. at 580, was *dictum*, and *Radford* was itself negated by a series of decisions of this Court rendered shortly thereafter. *See* Point I.B *infra*.

B. This Court's Well Settled Pre-Code Jurisprudence Allows Stripping Off Wholly Underwater Junior Mortgages

Beginning in the 1930s, this Court heard several bankruptcy appeals involving the rights of secured creditors whose collateral under junior mortgages was secured by property whose value was not sufficient even to cover the senior mortgage on the property. Under the Court's jurisprudence developed in several ground-breaking opinions, a junior mortgagee's rights were held to be limited to the value of the collateral, as determined by the court in the bankruptcy case. *See, e.g., Church Street*, 299 U.S. at 27. When the value of the property was insufficient even to pay the amount of a first mortgage on the property. this Court squarely held that a junior mortgage, lacking any collateral value, could be stripped off entirely and thereby eliminated. A valueless mortgage claim was thus treated for what it was, namely an unsecured claim. *See, e.g., Ecker*. 318 U.S. at 475–76.

By contrast, under *Radford*, decided in 1935 before this Court formulated its jurisprudence based on the value of a lien, first mortgage liens were viewed as enforceable after bankruptcy based on the amount due. Significantly, however, *Radford*'s earlier "full payment" view was *negated*

by several decisions of this Court that limited the rights of the creditor under a mortgage to the value of the property as determined by the court in the bankruptcy case. The *amici* urge that the Court should read section 506 in light of its pre-Code decisions, and that there is no basis for the Court to resurrect *Radford*'s discarded view that a mortgage cannot be terminated except by payment in full, particularly where, as here, the lien at issue is a wholly underwater junior mortgage.

The first of these groundbreaking decisions was *Church Street*, decided in 1936. The Court held that because the subject property was worth only 55% of the amount due on a first mortgage claim, a second mortgage had no collateral value to protect it, and the holders thus had no right to receive any distribution on their claims in a reorganization under section 77B of the former Bankruptcy Act. *See Church Street*, 299 U.S. at 27. As analyzed by this Court: "Here the controlling finding is not only that there was no equity in the property above the first mortgage, but that petitioners' claims were appraised by the court as having 'no value.' There was no value to be protected." *Id.*

Four years later, in *Union Central*, a case applying section 75, subs.(3) of the Bankruptcy Act as enacted in 1935, this Court held that the rights of a secured party were limited to the value of the collateral. *See Union Central*, 311 U.S. at 278. In that case the Act contained conflicting provisions. Under one provision, the debtor elected to redeem the subject property from a mortgage in the amount of $15,903.68 for the $6,000 value found by the bankruptcy court, and asserted its right to be discharged from an

obligation to pay the unpaid balance of the debt. *See Id.* at 276. After the debtor attempted to exercise this right, the mortgagee asserted another provision of the Act, which granted the mortgagee a right to compel a public sale of the property. *See Id.* at 276–77. In reconciling this statutory inconsistency, this Court ruled that the debtor's right to purchase prevailed, observing that the Act was intended to protect distressed debtors—in that case farmers—"faced with the disaster of forced sales and an oppressive burden of debt." *Id.* at 278. Specifically, the Court held that the debtor had the right to purchase the property at its value as determined by the court, observing that "[t]here is no constitutional claim of the creditor to more than that." *Id.* This result was reached even though the Act afforded a debtor three years to decide whether to elect to purchase the property, because during this period the rights of the creditor were protected "to the extent of the value of the property." *Id.* Rejecting "narrow formalistic interpretations which disregard the spirit and the letter of the Act," the Court held that the debtor was entitled to have the value of the property fixed by the court and to redeem at that value. *Id.* at 279, 281. To deny the debtor's right to redeem at the value fixed by the court "would be to rewrite the Act." *Id.* at 281.

Union Central was soon followed by this Court's decision in *Ecker*, which, relying on *Church Street*, held that the claims of creditors holding junior mortgages could be written off because the entire value of the properties had been exhausted by senior mortgages and thus were valueless. *Ecker*, 318 U.S. at 475–76. In so holding, the Court stated that the mere possibility that the property might

have increased earning power in the future did not require that the junior mortgagees be provided with an equity security by means of which they could share in a possible future increase in value. *See Id.* at 476. As stated in the leading treatise on pre-Code bankruptcy law, an underwater mortgage may be "appraised out, [i.e. stripped off] because a forced sale would leave nothing for it, even though there may be value behind the junior claims on a going concern basis." 5 *Collier on Bankruptcy*, ¶ 77.17, p. 583 (14th ed. 1978, first published in 1943) (citing *Church Street* and *Ecker*).

C. PETITIONER'S AND ITS *AMICI*'S POSITION IS NOT SUPPORTED BY *RADFORD*

Union Central, *Ecker*, and *Church Street* represent an important part of this Court's jurisprudence regarding the treatment of liens under the bankruptcy law. Indeed, in light of these decisions, it should not have been a surprise that section 506 was written to incorporate the well-established pre-Code doctrine under which valueless junior mortgages were stripped off. Despite the holdings of these cases, petitioner and its *amici* do not discuss or even cite the decisions in *Union Central*, *Ecker* and *Church Street*. Instead, they urge the Court to rely on the *dictum* in its earlier 1935 decision in *Radford*. Unlike its subsequent decisions that stripped off wholly underwater junior mortgages, *Radford* expressed the view that a mortgagee was entitled to the benefit of its bargain with the debtor, stating: "The right of the mortgagee to insist upon full payment before giving up his security has been deemed of the essence of a mortgage." 295 U.S. at 580. *Radford*'s view, however, in addition to

having been later negated, was merely *dictum*. The Court's holding was that the retroactive application of the statute at issue to pre-existing mortgages violated the Fifth Amendment's prohibition against impairing the obligations of contracts. *See Id.* at 589. In not perpetuating *Radford*'s *dictum*, this Court rejected *Radford*'s view that a mortgage continues to exist until full payment of the debt it secures and may be foreclosed, instead recognizing the reality that a wholly underwater junior mortgage is an unsecured claim.

Indeed, *Union Central* represents the antithesis of the position taken by the United States in its *amicus* brief filed in *Dewsnup*, upon which the Court relied in that case. There, the United States cited *Radford* as "[t]he best illustration of the clear understanding of the inviolability of liens in bankruptcy proceedings." United States' *Amicus* Br. for Resp. at 26. By sharp contrast, in an earlier decision in the *Union Central* case, this Court stated that "[p]roperty rights do *not* gain any absolute inviolability in the bankruptcy court because [they are] created and protected by state law." *Wright v. Union Central Life Ins. Co.*, 304 U.S. 502, 517 (1938) (emphasis added). Indeed, the Court made clear that Congress "may authorize the bankruptcy court to affect [state law] property rights, provided the limitations of the due process clause are observed." *Id.* Reliance by petitioner and its *amici* on *Radford* as demonstrative of a pre-Code "payment in full" entitlement of secured creditors missed the mark.

Invoking *Dewsnup*, LSTA's amicus brief misstates pre-Code bankruptcy law by stating that nothing in the old Acts empowered courts "to

compel a lienholder—holding a senior lien or a junior lien, regardless of the collateral's value—to release its collateral to the debtor while its loan remained unpaid." LSTA's *amicus* brief at 9. In an attempt to support that position, they too rely on *Radford*. *See Id.* ("this Court promptly invalidated the only statute that purported to grant that power.") (citing *Radford*, 295 U.S. at 581–82). The petitioner itself relies on *Radford* in the same improper manner: "the 'right of the mortgagee to insist upon full payment before giving up his security has been deemed of the essence of a mortgage' throughout the history of bankruptcy law." Pet. Br. at 23 (citing *Radford*, 295 U.S. at 580). Particularly, petitioners rely on *Radford*, arguing that "before the enactment of the Bankruptcy Code it was settled law that liens passed through liquidation proceedings unaffected, regardless of the value of the collateral securing them." Pet. Br. at 30 (citing *Dewsnup*, 502 U.S. at 418; *Radford*, 295 U.S. at 579).

Even though *Union Central* negated *Radford*'s rule that a creditor is entitled to full satisfaction of its debt before its mortgage may be affected, nowhere in petitioner's account of pre-Code history is *Union Central* mentioned. Likewise, *Union Central* is absent from petitioner's *amici*'s discussion of "the treatment of liens under the various federal bankruptcy statutes that predated" the Code. LSTA's *amicus* brief at 8. *Dewsnup* also did not cite *Union Central*.This omission may be explained by the fact that the treatment of valueless liens was not before the Court in *Dewsnup*, and because the Court there relied on *Radford*, which involved a *primary*

mortgage that was supported by substantial value.

The *amici* urge the Court not to rely on *Radford*'s negated *dictum*, particularly in this case involving a junior mortgage that is completely underwater, unlike the senior mortgage in *Radford* that was backed by substantial collateral value. Indeed, the Court should read section 506 as it was written, just as this Court read the earlier bankruptcy acts in its major pre-Code opinions that superseded *Radford*. The petitioner and its *amici* offer no plausible reason for calling on the Court to rehabilitate *Radford* and to reject the established pre-Code practice allowing wholly underwater mortgages to be stripped off.

D. *Long v. Bullard* Did Not Establish a Principle that Liens Pass Through Bankruptcy Unaffected

The *amici* urge that *Long v. Bullard*, upon which petitioner and its *amici* also rely heavily, does not, as claimed by petitioner and its *amici*, establish a general principle that liens pass through bankruptcy unaffected. Although some more recent cases have relied on *Long* for that principle, *Long* did not so hold and did not articulate that principle. In *Long*, a creditor loaned money to the debtor, a portion of the proceeds of which were "used to pay off the incumbrance on the homestead." 117 U.S. at 619. With the payoff of the existing mortgage, the mortgage received by the creditor as security for the loan became a first mortgage. *Long* did not involve and did not address the treatment of a valueless junior mortgage under the bankruptcy

law. The issue before the Court was "the effect of the discharge in bankruptcy upon the right of [a creditor] to enforce a lien upon the property in existence at the time of the commencement of the proceedings in bankruptcy." *Id.* at 620. Holding that the discharge did not release the lien, the Court deemed a state foreclosure proceeding proper. *See Id.* at 621. *Long* stands for the proposition that a bankruptcy *discharge* does not affect a lien that is valid under state law. *See Id.* In fact, applying the Court's holding in *Long* to situations involving underwater junior liens is especially improper, considering *Long*'s limited scope. *Long* did not hold or say that a mortgage could not be voided for a reason *other than* a discharge, for example because of the valuelessness of a mortgage. Expanding *Long*'s holding beyond its boundary not only misstates the case, but also inaccurately depicts the pre-Code jurisprudence of this Court regarding the treatment of valueless junior liens.

The *amici* urge that *Long* does not preclude the stripoff of a valueless junior mortgage. Although some much more recent cases view *Long* as pronouncing a broad rule that, by virtue of the pre-Code bankruptcy law, a mortgage survives bankruptcy unaffected, that statement is incorrect in light of the established pre-Code practice to write off valueless junior mortgages. As held by *Long*, the *discharge* of the debtor "did not relieve the property from the operation of liens created by contract before the bankruptcy." *Id.* at 621. The Court's decision, moreover, did not explain how liens operate in all circumstances, having only considered how a first mortgage operated where, as in *Long*, the mortgage appeared to have been a

fully secured first mortgage. *Long's* holding that a bankruptcy discharge does not *by itself* operate to prevent the enforcement of a mortgage, is far more limited than the broad meaning attributed to it, to the effect that the bankruptcy law's protection of a lien from the operation of a discharge precludes the termination of a lien under a provision of the bankruptcy law. Such provisions were sustained and applied under this Court's pre-Code jurisprudence, and section 506 should likewise be read and applied just as Congress wrote it.

Petitioner's *amicus*, LSTA, misunderstanding the text and purpose of section 67d of the Bankruptcy Act of 1898, also mistakenly argues that former section 67d operated to preserve liens after bankruptcy. *See* LSTA's *amicus* brief p. 15. Former section 67d, which was succeeded by the fraudulent conveyance provisions of section 548 of the Code, clearly stated that a lien would not be affected by the 1898 Act only if the lien was created in good faith, for a present consideration, and "not in fraud under this Act." Section 67d had nothing whatever to do with undersecured or wholly unsecured mortgages. Moreover, *City of Richmond v. Bird*, 249 U.S. 174 (1919), was misleadingly cited by LSTA in support of its section 67d argument. There was no claim in that case that the lien in question was fraudulently obtained, this Court having also stated: "It is not denied that respondents obtained a present valid lien upon the bankrupt's goods . . . ; nor is it now claimed this was annulled by adjudication of bankruptcy." *Id.* at 175.

Petitioner's LSTA *amici*, in urging that the bankruptcy law bars the stripoff of a mortgage, also misunderstand the limited effect of a

bankruptcy discharge on a mortgage, as explained in the first edition of Collier quoted by LSTA at page 17 of their brief. There, Collier merely stated that if mortgages are valid under state law and not rendered void by a bankruptcy act, "the bankrupt's discharge will not prevent their enforcement." There is no basis for subsequent cases to transform that narrow statement into a global proposition that reads the bankruptcy discharge as immunizing mortgages from termination in accordance with a bankruptcy law provision.

When Congress amends the bankruptcy laws, it is "not writing on a clean slate." *Emil v. Hanley*, 318 U.S. 515, 521 (1943). Congress was presumably aware of the pre-Code practice of stripping off wholly underwater junior liens. The Code should thus be understood and read in light of that pre-Code practice implementing this Court's pre-Code jurisprudence.

POINT II

SECTION 506(d) REFLECTS THIS COURT'S JURISPRUDENCE UNDER WHICH A VALUELESS JUNIOR MORTGAGE MAY BE STRIPPED OFF

A. Just As Congress Provided for Stripping Off Junior Mortgages in Reorganization Cases in the Pre-Code Era, It Did So in Section 506(d)

1. The Bankruptcy Code only protects liens to the extent of the collateral's value

Under the plain language of section 506(a), a claim secured by a lien is protected only to the extent of the value of the collateral. The clear

import of section 506(a), a part of the Code section entitled "Determination of secured status," is to bifurcate allowed claims into secured and unsecured portions. Under section 506(a), a claim is secured only to the extent of the value of the property securing the claim. *See United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235, 239 (1989) (stating "a claim is secured only to the extent of the value of the property on which the lien is fixed."). This portion of the claim, secured up to the value of the collateral, is referred to throughout the Code as an "allowed secured claim." *See, e.g., Harmon v. United States through Farmers Home Admin.*, 101 F.3d 574, 584 (8th Cir. 1996); *In re Cummings*, 214 B.R. 126, n.1 (D.N.J. 1997). The remainder of the allowed claim is treated and defined by section 506(a) as an "unsecured claim." As such, it does not enjoy the protections afforded to a "secured claim."

Section 506(a)'s bifurcation directive should be carried into section 506(d), just as the courts have carried section 506(a) into sections 506(b) and (c). *See, e.g., In re Gledhill*, 164 F.3d 1338, 1340 (10th Cir. 1999) (applying the section 506(a) definition of allowed secured claim to section 506(b)); *In re Golden Plan of Calif., Inc.*, 829 F.2d 705, 712 (9th Cir. 1986) (applying the section 506(a) "defin[ition of] allowed secured claim" to section 506(c)). It defies normal rules of statutory construction to hold that "allowed secured claim" holds one meaning in sections 506(a)–(c), and a different meaning in section 506(d). *See Dewsnup*, 502 U.S. at 422 (Scalia, J., dissenting) ("We have often invoked the 'normal rule of statutory construction that' 'identical words used in different parts of the same act are intended to have the same

meaning.'") (citing *Sullivan v. Stroop*, 496 U.S. 474, 484 (1990)).

Before *Dewsnup*, courts understood that, under the Code, liens were protected only to the extent of the value of collateral, and not to the full extent of the claim. *See, e.g., In re Briggs Transp. Co.*, 780 F.2d 1339, 1347 (8th Cir. 1985) ("[A]s a secured creditor, it will be paid in full up to the lien value of the collateral."); *Matter of Gifford*, 669 F.2d 468, 480 (7th Cir. 1982) ("Historically, lien rights have entitled their holders to the value of collateral and no more in bankruptcy."). In *United Sav. Assn. of Tex. v. Timbers of Inwood Forest Assoc., Ltd.*, this Court suggested that liens are only protected up to the collateral's value. 484 U.S. 365, 372 (1988) (herein "*Timbers*"). In *Timbers*, this Court held that undersecured creditors are not entitled to be compensated under section 362 for the delay in foreclosing on their collateral caused by the automatic stay. *See Id.* at 379. Thus, the Court in *Timbers* understood that what was protected by the provision for adequate protection under section 361 is the value of the collateral, and nothing else. In reaching this conclusion, *Timbers* used section 506(a)'s definition of "value of such creditor's interest" in section 506(a), *i.e.* "the value of the collateral," in reaching the conclusion that the phrase "value of such entity's interest" in section 361 has the same meaning as provided by section 506(a). *Id.* at 372. *Timbers*, therefore, strongly suggests that section 506(d) must be construed in the same manner, namely by only protecting a claim secured by property to the extent of the value of the property. Even after *Dewsnup*, courts continued to recognize that liens are only protected up to the value of the

collateral. *See, e.g.*, *Wade v. Bradford*, 39 F.3d 1126, 1129 (10th Cir. 1994) (stating that "*Dewsnup*'s holding cannot be imported into Chapter 11 cases"); *In re Pond*, 252 F.3d 122, 127 (2d Cir. 2001) ("[T]o determine whether a lien is 'secured' under Section 506(a), a court must examine the value of the collateral underlying a lien, not the value of the lien itself.").

Indeed, Congress itself understood that the Code was to treat undersecured creditors as having protection only to the extent of the value of the collateral, and thus did not protect valueless junior liens. The House Report in connection with the Bankruptcy Reform Act of 1978 states: "the bill makes clear that an undersecured creditor is to be treated as having a secured claim to the extent of the value of the collateral, and an unsecured claim for the balance of his claim against the debtor." H.R. Rep. No. 95-595, p. 181 (1977). Furthermore, Congress clearly intended for such protection to extend throughout the Code. H.R. Rep. No. 95-595, at p. 356 ("Throughout the bill, references to secured claims are only to the claim determined to be secured under this subsection [506(a)], and not to the full amount of the creditor's claim.").

2. The multiplicity of lien avoidance and modification provisions bears on the notion that section 506(d) authorizes stripoffs of valueless junior mortgages

Congress dealt in a comprehensive way with the treatment of liens under the Code. To do so, it had to deal with liens requiring special treatment other than because of the value of the collateral supporting them. There are many such provisions

in the Code. Section 506(d), on the other hand, is the provision addressing the treatment of liens based on the value of the collateral securing a claim.

Without regard to whether a lien is fully secured, undersecured, or valueless, multiple sections of the Code provide directly for lien avoidance. *See, e.g.*, 11 U.S.C. § 510(c)(1) (providing for equitable subordination of liens); 11 U.S.C. § 522(f) (providing for the avoidance of a lien to the extent it impairs an exemption of the debtor); 11 U.S.C. § 547(b) (providing for the avoidance of preferential liens); 11 U.S.C. § 548(a) (providing for the avoidance of a fraudulently incurred lien).

Numerous other Code sections cover situations in which certain liens may be subordinated, modified, or avoided completely. For example, section 364(d)(1), applicable in chapter 7 by virtue of section 103, authorizes the subordination of a pre-petition lien to a new senior mortgage if it is necessary for a trustee or a debtor in possession to obtain credit. This results in terminating the senior priority status of the prior lien and relegating it to a junior position behind a newly created senior lien. *In re Adams Apple, Inc.*, 829 F.2d 1484, 1490 (9th Cir. 1987) ("Congress provided in section 364(d) that pre-petition debts, even secured interests, may be subordinated by post-petition obligations . . . [I]t indicates a Congressional willingness to subordinate the interests of pre-petition creditors to the goal of rehabilitation."). Under this provision, a senior lien may be subordinated. Other special provisions of the Code dealing with the treatment of liens are sections 545, 552, and 724.

Thus, the old adage that "liens pass through bankruptcy unaffected" cannot be taken literally under the Code; that saying is, at best, misleading. Cases decided both before and after *Dewsnup* understood the fact that liens are regularly affected in bankruptcy. *Matter of Lindsey*, 823 F.2d 189, 190 (7th Cir. 1987) (calling the principle "no better than a half-truth"); *Harmon* 101 F.3d at 581 ("[I]t is not even accurate to say that liens pass through Chapter 7 unaffected."). Clearly, liens are affected by bankruptcy in innumerable ways, and thus do not "pass through bankruptcy unaffected."

B. Petitioner Reads Section 506(d) Only to Void a Lien that Secures a Claim Disallowed Under Section 502(b)(1). Congress Would Not Enact a Provision that is Superfluous

In its brief, petitioner contends that section 506(d) exists solely to establish the treatment of a secured claim that is disallowed under section 502, only voiding a lien because the claim it secures has been disallowed under section 502. Pet.Op.Br. at 32–33. This argument is fatally flawed, as section 506(d) would do nothing that does not already occur under state law, and would thus render section 506(d) superfluous. Under section 502(b)(1), a court determines the enforceability of a disputed claim after notice and hearing. Part of such a determination involves adjudicating the enforceability of the claim itself. *Katchen v. Landy*, 382 U.S. 323, 329 (1966); *Vanston Bondholders Protective Cmte. v. Green*, 329 U.S. 156, 170 (1946); *In re Hann*, 476 B.R. 344, 355 (1st Cir. B.A.P. 2012). Petitioner

erroneously contends that if a secured claim is disallowed under section 502(b), section 506(d) exists solely to invalidate the lien securing that claim. Such an interpretation would render section 506(d) superfluous, because such a reading of it would accomplish nothing more than what state law by itself already does.

Under state law, the vitality of a mortgage depends on the enforceability of the claim it secures; if a debt is unenforceable, so too is the lien securing it. *Carpenter v. Longan*, 83 U.S. (16 Wall) 271, 274 (1872) ("An assignment of the note carries the mortgage with it, while an assignment of the latter alone is a nullity . . ."); *Coon v. Shry*, 209 Cal. 612, 615 (1930) ("[T]he mortgage must stand or fall with the note . . . [A] mortgage or mortgage lien is a mere incident of the debt or obligation which it is given to secure. There cannot be a mortgage if there is no debt or other obligation to be secured.") (internal citations omitted). For instance, any attempt to assign a lien without assigning the debt underlying it is a nullity. *Jordan v. Sayre*, 24 Fla. 1, 19 (1888) ("It is true that an assignment simply of the mortgage or of the mortgagee's interest in the land, without the debt, is held to be a nullity."); *Flyer v. Sullivan*, 134 N.Y.S.2d 521, 523 (App. Div. 1st Dep't. 1954) (citing *Jackson ex dem. Curtis v. Bronson*, 19 Johns. 325, 326 (N.Y. Sup. Ct. 1822)); *Fassett v. Mulock*, 5 Colo. 466, 469 (1880); *Schleuter Co., Inc. v. Sevigny*, 564 N.W.2d 309, 314 (S.D. 1997); *Bryan v. Easton Tire Co.*, 262 Ark. 731, 732 (1978) ("The note and the mortgage are inseparable. An assignment of the note carries the mortgage, while an assignment of a mortgage alone is a nullity.").

Thus, by operation of state law, a lien is unenforceable if the underlying claim is unenforceable under applicable law or any agreement, and section 506(d) is not required to invalidate the lien. Therefore, reading section 506(d) as petitioner urges would render that subsection superfluous. Congress does not write superfluous or wasteful laws. *Knight v. C.I.R.*, 552 U.S. 181, 190 (2008) ("Thus, accepting the Trustee's approach 'would render part of the statute entirely superfluous, something we are loath to do.'") (citing *Cooper Indus., Inc. v. Aviall Svcs., Inc.*, 543 U.S. 157, 166 (2004)); *Kelly v. United States*, 826 F.2d 1049, 1052 (Fed. Cir. 1987) ("To [construe a statute in a superfluous way] would be to say that Congress wrote a meaningless provision into the law. We will not attribute such incompetence to Congress.") (internal citations omitted).

POINT III

BANKRUPTCY'S UNDERLYING GOAL TO PROVIDE DEBTORS WITH A FRESH START IS IMPORTANT IN CHAPTER 7

The pre-Code principle protecting mortgages only to the extent of the value of the collateral is supported by the bankruptcy law's fundamental goal of providing an honest debtor with a fresh start. The Court explicitly acknowledged this pre-Code principle. *See, e.g., Burlingham v. Crouse*, 228 U.S. 459, 473 (1913) (noting that exemptions evidence the bankruptcy purpose to give the debtor a fresh start); *see also* H.R. Rep. 95-595, at p. 118 (1977) ("Whether the debtor uses chapter 7, liquidation, or chapter 13, adjustment of debts of

an individual, bankruptcy relief should be effective, and should provide the debtor with a fresh start."); *Marrama v. Citizens Bank of Mass.*, 549 U.S. 365, 367 (2007) ("The principal purpose of the Bankruptcy Code is to grant a fresh start to an honest but unfortunate debtor.") (internal citation omitted).

Stripoffs enable debtors to retain their property. For example, freeing the debtor's property from a wholly underwater junior lien would enable the debtor to negotiate with the primary lender to reach an agreement that reduces the mortgage debt to the value of the property and avoids foreclosure. After a bankruptcy, this could enable the debtor to retain the property and also yield a greater recovery by the first mortgagee than could be otherwise realized in a foreclosure sale. However, such an agreement cannot be implemented without the consent of the holder of a junior mortgage on the property, and the junior mortgagee is thus in a position to block such an agreement. The holder of a valueless junior mortgage, which would be wiped out by a foreclosure of the first mortgage, has no economic interest in withholding its consent, except to block such an agreement until it is able to extract a payment on its valueless mortgage. This is good reason to allow the stripoff of valueless second mortgages. Surely Congress did not intend to protect the ability of the holder of such a mortgage to obtain a payment in that manner, in preference to the debtor's fresh start.

With respect to individuals especially, the ability to remain in their homes should be recognized as a more important interest than that of the holder of a wholly underwater junior mortgage. Bankruptcy exemption laws protect the

debtor's property, and particularly protect a debtor's continued ownership of his or her home. The purpose of the exemption statutes should guide the Court's determination of how mortgages are treated in bankruptcy cases. *See In re Bartlett*, 168 B.R. 488, 493–94 (Bankr. D.N.H. 1994) (noting that at its core, a "'fresh start' is only feasible if the debtor emerges from bankruptcy with a means of providing the necessities of life, including a roof overhead, and the homestead exemption is directed at making this attainable."). In that light, a valueless second mortgage should be subject to being stripped off as a means of furthering the debtor's continued home ownership and fresh start.

Moreover, as noted earlier, petitioner and its *amici* have not offered a cogent economic basis for precluding stripoffs of valueless junior mortgages in chapter 7 cases. Their attempt to protect on-going investment opportunities for private equity firms by means of high-yield second mortgages does not support the dire consequences they predict will result from allowing such stripoffs. However, no such concern has been expressed in this case by the United States. The United States did express a concern for the strip down of *first* mortgages in its *amicus* brief filed in *Dewsnup*. It chose *not* to file an *amicus* brief in this case, suggesting that it is not concerned that such consequences will result from allowing stripoffs of valueless second mortgages. The concern of petitioner's *amici* is unwarranted, and should be directed to the Congress, not this Court.

CONCLUSION

Based on the foregoing and on respondents' brief, the order appealed from should be affirmed.

Respectfully submitted,

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